BEFORE THE
Federal Communications Commission
WASHINGTON, D.C.

In the Matter of	)	
	)	
Implementation of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Rate Regulation	)	
	)	
Third Notice of Proposed Rulemaking	)	

REPLY COMMENTS OF TIME WARNER ENTERTAINMENT COMPANY, L.P.

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Summary

Time Warner reiterates that the Commission's first proposal for pricing the addition or deletion of channels -- pricing new channels at the new benchmark rate -- is preferable to its tentative proposal to price additional channels based on the benchmark curve. The first proposal is simple and easy to administer. Moreover, the fundamental infirmities inherent in the benchmark rates and the benchmark curve should not be replicated in the pricing of additional channels. Indeed, the debate is replete with examples of deficiencies in the Commission's tentative proposal. Thus, the third proposal should be rejected and the method of pricing new channels at the new benchmark rate should be adopted.

The record reflects a consensus that a single cost-of-service election must be rejected. A single election will only serve to unnecessarily increase the number of cost-of-service hearings with no attendant benefits. It is possible, however, for cable operators to voluntarily decide to undertake a cost-of-service hearing for all regulated services. In such cases, the Commission must address the procedural difficulties inherent in a dual jurisdictional framework. Such procedures are constrained by the jurisdictional dichotomy between the FCC and local authorities at the heart of the Cable Act.

In addition, Time Warner believes that franchise required upgrades should be treated like other franchise requirements -- as external costs.

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Reply Comments of Time Warner Entertainment Company, L.P.

Time Warner Entertainment Company, L.P. ("Time Warner"), by its attorneys, hereby files its reply comments in connection with the Third Notice of Proposed Rulemaking in this proceeding.[1] Time Warner is a partnership, which is primarily owned (through subsidiaries) by Time Warner Inc., a publicly traded Delaware corporation. Time Warner comprises principally three unincorporated divisions: Time Warner Cable, which is the second largest operator of cable television systems nationwide; Home Box Office, which operates pay television programming services; and Warner Bros., which is a major producer of theatrical motion pictures and television programs. Time Warner

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[1] Implementation of Rate Regulation Sections of the Cable Television Consumer Protection and Competition Act of 1992, First Order on Reconsideration, Second Report and Order and Third Notice of Proposed Rulemaking, MM Dkt. No. 92-266 (rel. Aug 27, 1993) ("Third Notice").

Cable, which owns and operates cable systems in approximately 1,500 franchise areas throughout the United States will be directly affected by rules the Commission adopts regarding the regulation of cable rates. An active participant in all phases of this docket to date, Time Warner is an interested party in this proceeding.[2]

I. Benchmark Adjustments Due to Channel Addition or Deletion

The comments filed in response to the Third Notice point out the deficiencies in the Commission's tentative methodology for dealing with channel additions and deletions.[3] Those deficiencies include: (1) the replication of the shortcomings in the benchmark itself and the database used to derive it; (2) the perverse results for subscribers and non-recovery of costs which occurs if the methodology is applied in a tier-neutral fashion; and (3) the definitional and calculative

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[2] This pleading is submitted without prejudice to Time Warner's claims and arguments in its pending lawsuits challenging various provisions of the Cable Television Consumer Protection and Competition Act of 1992, Pub. L. 102-385, 106 Stat. 1460 (1992). See Turner Broadcasting System, Inc. v. Federal Communications Commission, No. 92-2247 (D.D.C. April 8, 1993)(U.S. Supreme Court noted probable jurisdiction, No. 93-44, September 28, 1993); Discovery Communications, Inc. v. U.S., No. 93-9150 (D.C. Cir.); Time Warner Entertainment Company, L.P. v. FCC, No. 93-1266 (D.D.C.); Daniels Cablevision, Inc. v. United States, No. 92-2292 (D.D.C.).

[3] Certain of the comments deal with issues -- such as the definition of programming costs, the question of allowing a mark-up thereon, and advertising and bill itemization -- which the Third Notice explicitly states will be addressed elsewhere. Since these issues are thus not appropriately raised in comments on the Third Notice, Time Warner does not address those issues in this Reply.

uncertainties and difficulties associated with the Commission's approach.[4] These deficiencies should cause the Commission to adopt the first methodology discussed in the Third Notice (adding new channels only at the new benchmark rate) or one of the proposed combinations of the first and third methodologies suggested by certain commenters.[5] Combining the first and third methodologies would provide incentives to cable operators to add channels carrying high quality programming.

Time Warner continues to believe that simply pricing new channels at the "new" benchmark rate is far preferable, as a matter of simplicity and public policy, to the Commission's tentative proposal. However, the infirmities of the tentative proposal pale in comparison to the second methodology discussed in the Third Notice -- pricing channel additions by applying the new benchmark rate, not only to the new channel, but to the "old" ones as well. This proposal, rejected by the Commission in the Third Notice,[6] is advanced by NATOA in its comments without justification or support.[7] Beyond creating the odd set of incentives identified in the Third Notice, this proposal would

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4 See e.g., Comments of Time Warner at 3-4. It is not only cable operators who view the Commission's third alternative with trepidation. NATOA describes it as "unduly complicated" and "not easy to administer." Comments of NATOA at 15.

5 See e.g., Comments of The Hearst Corporation at 11; Comments of Liberty Media Corporation at 6-7; and Comments of the National Broadcasting Company, Inc. at n.3.

6 See Third Notice at ¶ 138.

7 See Comments of NATOA at 15-16.

make it extremely difficult for cable operators to add new programming, especially higher cost programming. This is so simply because the revenues generated by the new channel would have to be great enough to offset the decrease in rates on all of the "old" channels. Because the benchmark curve is steeper at lower channel capacities, this disincentive to add new programming would be most pronounced for precisely those systems where additional programming would, from a policy standpoint, be most desirable.

Whatever methodology the Commission settles on should be applied on a tier-specific basis. Otherwise, under the several scenarios identified in the comments,[8] a channel addition or deletion would result in a change in rates for subscribers not seeing a change in service. Considerations of subscriber-relations and logic aside, such governmentally-mandated anomalous results could be in conflict with the Commission's statutory obligation to "ensure that the rates for the basic service tier are reasonable."[9]

Time Warner also respectfully reiterates its concern that the Commission address the procedures for making channel additions and corresponding rate changes to ensure that channel additions are not needlessly delayed pending franchising

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[8] See e.g., Comments of Continental Cablevision, Inc. at 11-12; Comments of Falcon Cable TV et. al at 7-8; Comments of The Hearst Corporation at 5-6; and Comments of the National Cable Television Association at 7.

[9] 47 U.S.C. § 543(b)(1); Communications Act of 1934, § 623(b)(1).

authority approval of a rate change for basic cable service.[10] In this regard, the Commission should note that concern is shared by the New York State Commission on Cable Television.[11]

Austin, Texas _et. al_ apparently argues that if a cable operator agrees with a broadcaster to carry a new programming service and adds a channel in order to do so, the Commission's channel addition methodology should not allow the cable operator any compensation for carrying the new channel.[12] Such a rule is at odds with the public policy goal of enhancing consumer programming choices. Moreover, a cable operator confronted with the rule that Austin urges the Commission to impose would simply substitute such programming for existing programming rather than add capacity for which it will not be reimbursed. The proposed rule also puts the Commission in the constitutionally untenable position of penalizing certain speech simply because of the identity of the speaker -- here, an affiliate of a broadcaster. Such a result is not compelled by the Act,[13] and is contrary to the best interests of subscribers, cable operators and cable programmers.

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[10] _See_ Comments of Time Warner at 5.

[11] _See_ Comments of the New York State Commission on Cable Television at 3.

[12] Comments of Austin, Texas _et. al_ at 9.

[13] In fact, one of the purposes of the Cable Act is "to assure that cable communications provide and are encouraged to provide the widest possible diversity of information sources and services to the public." 47 U.S.C. § 521; Communications Act of 1934, § 601(4).

II. A Single Cost-of-Service Election Should Not Be Required

Time Warner's initial comments and those of several other parties demonstrated that allowing separate cost-of-service elections will not create incentives for operators to "game" the regulatory process.[14] Not only does the regulatory scheme already in place prevent "gaming," the costs attendant to full cost-of-service hearings and the possibility that they could result in below benchmark rates will deter cost-of-service showings except in cases where costs justify a rate which is significantly in excess of the benchmark rate. Therefore, a decision to require a single election will unnecessarily increase the number of cost-of-service showings with no attendant benefits.

Because it is possible that a cable system might face both local and federal cost-of-service hearings the Commission should address the substantive and procedural difficulties inherent in this dual jurisdictional framework.[15] In addressing these issues the Commission is constrained by the jurisdictional dichotomy between the local franchising authorities and the Commission established by the Cable Act. The Act gives local

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[14] See e.g., Comments of Time Warner at 7-8; Comments of Cablevision Systems Corporation at 2-3; Comments of the Community Antenna Television Association, Inc. at 8-10; Comments of Joint Parties at 11-12; and Comments of Tele-Communications, Inc. at 8.

[15] In the event the Commission mandates that cable operators make a uniform benchmark/cost-of-service election it is even more imperative that it deal with the substantive and procedural issues that dual cost-of-service hearings implicate.

franchising authorities primary jurisdiction over basic cable service, and no more. The Commission is given jurisdiction over cable programming services and is the forum for appeals of local rate decisions regarding basic cable service.

Given the Commission's jurisdiction over all regulated tiers, it must ensure against the inconsistent resolution of cost allocation and related issues in the two jurisdictions. When two independent jurisdictions each make independent judgments concerning the allocation of regulated costs between the regulated service tiers, there is a clear possibility that some legitimate costs will be "lost" and hence unrecoverable. Because, at the very least, the Commission will be reviewing basic cable service cost-of-service determinations and conducting its own cable programming service tier cost-of-service proceedings, it is in a position to prevent both inconsistent results and the possibility of less than full cost recovery. A failure to so protect against the non-recovery of reasonable costs raises issues of constitutional dimension.

In order to maximize efficiencies and ensure against inconsistent results if cost-of-service hearings are to be held for both basic cable service and cable programming service tier rates, the FCC should consolidate such hearings at the federal level.[16] A single hearing is the most efficient way to insure

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[16] As the Municipal Franchising Authorities recommended, the local franchise authorities should be party to, and bound by, the Commission's consolidated cost-of-service hearing. See Comments of Municipal Franchising Authorities at 8.

consistent results and reduce administrative burdens. Moreover, a single hearing at the local level is not an option because the Commission lacks the power under the Cable Act to bestow jurisdiction over cable programming service rate determinations to local franchising authorities.[17]

All suggestions to circumvent the bifurcated regulatory scheme by extending authority to local regulators beyond that expressly set out in the Cable Act must be rejected. For example, NATOA suggests that a "franchising authority, in its sole discretion, should have the right to adopt and apply the Commission's rate decision, if appropriate, or to make a different rate decision consistent with the Commission's rules."[18] Franchising authorities cannot be accorded the heretofore unknown privilege of "pick and choose" res judicata without undermining both the constitutional rights of parties to the Commission's proceedings and the Commission's preemption authority. Since the Commission has authority over both cable programming services and basic cable service, its judgments must bind local authorities.

As Time Warner stated in its Comments, cable operators should be permitted to switch for cause between benchmark and cost-of-service regulation at any time. The variables that

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[17] NATOA's suggestion that reviews be conducted by both local authorities and the Commission is without merit. See Comments of NATOA at 12. Rather than requiring operators to trigger separate proceedings in both jurisdictions, administrative convenience dictates consolidation.

[18] See Comments of NATOA at 14.

influence such elections do not work on a regular schedule; accordingly the form of regulation should be subject to adjustment irrespective of the calendar. While allowing an election on only an annual basis has a superficial appeal,[19] it raises for the Commission, franchising authorities and cable operators a host of difficult issues regarding recoupment of past costs from a current subscriber base. At the very least, the Commission should permit cable operators to make the election yearly.

Austin, Texas et. al argue for a requirement that a cable operator "make a threshold showing that benchmark rates do not enable the operator to earn a reasonable return on the overall system, including revenues from unregulated as well as regulated sources" before it initiates a cost-of-service hearing.[20] They state that such a threshold hearing is necessary to prevent operators from abusing the system by, for instance, initiating monthly cost-of-service hearings. Clearly, to the extent such abuses are a realistic concern, they can be prevented by more tailored means.[21] In reality, Austin's argument is a thinly disguised attempt to extend rate regulation to unregulated services -- such as pay-per-view -- in contravention of the Cable

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[19] Even NATOA recognizes the value in permitting operators to switch between cost-of-service and benchmark regulation on at least a calendar year basis. See Comments of NATOA at n.6.

[20] See Comments of Austin, Texas et. al at 12.

[21] Even under Austin's proposed "solution" to this hypothetical problem, a cable operator could presumably seek to make the requisite threshold showing on a monthly basis.

Act. The Act requires cable operators to charge "reasonable" rates for basic cable service and "not unreasonable" rates for cable programming services. The rates for such services are either appropriate or not. And the answers to those questions does not, and statutorily cannot, depend on what a cable operator charges for services which, under the express language of the Act, are unregulated.

III. Upgrades Required by Franchising Authorities

As Time Warner and numerous other commenters stated in the initial comments,[22] franchise-required upgrades should be treated like other franchise requirements -- as external costs. NATOA, on the other hand, demands that all upgrade costs, regardless of whether the upgrades are voluntary or mandatory, be treated as non-external costs. NATOA says that "there is no rational basis for the distinction in treatment" between franchise-imposed upgrades and unilateral, voluntary system upgrades.[23] This is simply untrue. Upgrades that arise under the terms of the franchise are requirements enforceable by the franchise authority. Often, such upgrades must be performed as a condition to an operator's authority to do business. As such, they are radically different from improvements the operator

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[22] See e.g., Comments of Time Warner at 11; Comments of Cablevision Systems Corporation at 18; Comments of Joint Parties at 17; Comments of NCTA at 17-18; and Comments of Tele-Communications, Inc. at 10.

[23] See Comments of NATOA at 4.

unilaterally decides to undertake. Voluntary upgrades do not carry time constraints and can be altered without consequence. The analogy more appropriately lies between franchise required upgrades and other franchise requirements. Both categories of costs are mandated as a condition of the franchise. Both should be given external cost treatment.

Austin, Texas et. al continue to oppose any recovery of upgrade costs under either regulatory framework.[24] Thus it is not surprising that they oppose external cost treatment for franchise-required upgrades. Permitting benchmark recovery of future franchise-required upgrades will not result in double recovery, despite Austin's assertions to the contrary, for the simple reason that the benchmarks are not clairvoyant. Thus there is no empirical basis for the assertion that costs of future upgrades are included in the benchmarks.

Austin also argues that there is no reason to assume that "upgrades require increases in rates to recover costs."[25] That is correct. But it is also the case that there is no reason to assume that upgrades will never require increases in rates to recover costs. Whether or not upgrades impose additional net costs on cable operators is a factual question requiring a factual determination. Such factual questions are to be resolved in upgrade cost determinations -- not assumed away in favor of artificially low rates.

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[24] See Comments of Austin, Texas et. al at 1-2.

[25] See Comments of Austin, Texas et. al at 3.

Some of the definitional issues surrounding upgrade cost determinations will undoubtedly be resolved when the Commission promulgates rules defining which costs are to be included within the ambit of franchise-required upgrades and thus accorded external cost treatment. Despite Austin's protestations to the contrary, this inquiry is not in kind different from, or more complicated than, the Commission's effort to define programming costs entitled to external cost treatment.[26]

IV. Conclusion

For the foregoing reasons, Time Warner respectfully recommends that the Commission adopt rules consistent with the comments herein.

Respectfully submitted,

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[26] See e.g., Third Notice at n. 244.